

Agency SOFR Cap Update

Freddie and Fannie kicked off their transition from LIBOR to SOFR floating rate products in late Q3 2020. With many multifamily borrowers beginning to close on their first SOFR based loans, we wanted to address some of the frequently asked questions and provide an update with where things stood on Agency SOFR caps.

LIBOR vs. SOFR – Cap Economics

The switch to SOFR doesn't change much as far as the economics of the underlying interest rate cap. The Agencies selected NY Fed 30D SOFR as the replacement index, and aside from a couple tweaks to the language, everything pretty much looks and feels the same.

Index – [BBA USD LIBOR \(1 month\)](#)

Accruals – from and including the 1st calendar day of each month to but excluding the 1st calendar day of the following month

Payments – paid on the 1st calendar day of the next Accrual period

Resets – 1st day of each Accrual period with a one (1) [London](#) banking day lookback on resets

Index – [NY FED 30D SOFR](#)

Accruals – from and including the 1st calendar day of each month to but excluding the 1st calendar day of the following month

Payments – paid on the 1st calendar day of the next Accrual period

Resets – 1st day of each Accrual period with a one (1) [New York](#) banking day lookback on resets

SOFR cap providers and execution

Most of the banks previously approved to sell Agency LIBOR caps are set up to trade Agency SOFR caps too. Overall, the transition has been very smooth and there are no notable changes to the onboarding and execution process.

Below we've included a list of Agency approved cap providers and our understanding of their timelines to get up and running.

Bank	LIBOR Caps		SOFR Caps	
	Freddie	Fannie	Freddie	Fannie
SMBC	Yes	Yes	Yes	Yes
US Bank	Yes	Yes	Yes	Yes
Wells Fargo	Yes	Yes	Yes	Yes
BoNY	Yes	No	Yes	Very Soon
RBC	Yes	Yes	TBD	TBD
Barclays	Yes	N/A	TBD	N/A

**CBA will no longer be providing interest rate caps*

Premiums for SOFR caps

The only notable difference when comparing LIBOR and SOFR hedges is a slight premium for the latter index.

Due to thin market liquidity, many traders are hedging SOFR based caps using the same Eurodollar futures contracts that they would for LIBOR. Therefore, SOFR caps have traded at a premium to the LIBOR equivalent structures since banks must charge for the basis risk they face. We've included pricing comparing various structures below to help illustrate this.

LIBOR Index					SOFR Index				
Notional	\$25,000,000				Notional	\$25,000,000			
Index	1-month LIBOR				Index	NY FED 30D SOFR			
Ratings	Freddie Mac				Ratings	Freddie Mac			
Strike	3 Years	4 Years	5 Years		Strike	3 Years	4 Years	5 Years	
1.00%	\$ 129,000	\$ 257,000	\$ 474,000		1.00%	\$ 135,000	\$ 281,000	\$ 520,000	
1.50%	\$ 85,000	\$ 185,000	\$ 318,000		1.50%	\$ 90,000	\$ 205,000	\$ 356,000	
2.00%	\$ 65,000	\$ 142,000	\$ 246,000		2.00%	\$ 70,000	\$ 158,000	\$ 276,000	
2.50%	\$ 53,000	\$ 113,000	\$ 208,000		2.50%	\$ 58,000	\$ 125,000	\$ 230,000	

The cost difference between the two indices is subject to fluctuate as banks adjust their models, new developments are announced, and other banks enter the space.

What to expect going forward

Cap executions that feel the same as they did based on LIBOR. There's no need to worry about the cap impacting your closing, the process hasn't changed and is as smooth as before.

Many banks have already finished, or are wrapping up, document negotiations with Freddie and Fannie to be in a position to trade SOFR caps. We're optimistic that as more banks enter the space, and markets become more liquid, the premium for SOFR caps will ease.

Please don't hesitate to reach out should you have any questions or if we can do anything to help.

Resources

- [Pensford.com/SOFR](https://pensford.com/SOFR)
- <https://www.newyorkfed.org/arrc/sofr-transition>
- https://mf.freddiemac.com/news/2020/20200817_libor_transition_update.html
- https://multifamily.fanniemae.com/news-insights/multifamily-wire/new-arm-5-5-sofr-indexed-sarm-arm-7-6-and-hybrid-arm?_ga=2.153708728.1269969991.1603812566-1273951460.1603812566
- https://mf.freddiemac.com/news/2020/20200724_sofr_based_loan_rate_cap_announcement.html

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